Marble Harbor Investment Counsel, LLC
Third Quarter, 2022 Letter

We are pleased to send an excerpt from our quarterly client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, L.J. Harrington, Eric Robb, Daniel Rosenblatt and Howie Cowan

****

There's going to be a recession. We don't know when, but it's coming. Now we've said it. Let's move on.

If you've watched CNBC or read the *Wall Street Journal* over the past year, you'll have noted the parade of economists, historians and strategists who have all been competing to be the first to call when the U.S. is in a recession. This may sell advertising and attract clicks, but it's otherwise unhelpful. Fear mongering has resulted in renewed volatility in capital markets as traders flee equities, anxious about the mere whiff of a recession.

In past letters, we've spoken at length about inflation caused in part by three million baby boomers retiring en masse during the pandemic, supply chain challenges and natural gas shortages due to Russia's war in Ukraine. The Federal Reserve has the unenviable task of targeting stable prices in the U.S. Their main tool is setting interest rate policy. As the Fed raises interest rates, the economy should cool, bringing down inflation. At least that's the theory. Unfortunately, higher interest rates will not stop Vladimir Putin's war in Ukraine, unsnarl supply chains, stimulate more energy production or bring the baby boomers back into the workforce now that they've retired to Florida and Arizona. Interest rates are simply the wrong tool for the job, but they're the primary tool that the Fed has.

Higher interest rates seem to be nudging the world toward a recession. Weaker economies, such as those in Europe and Africa, are likely to be first in the queue, followed by China, Japan and the U.S. However, a recession isn't yet here. Low unemployment, a growing workforce and rising wages in an economy that is over 70% consumer spending are not the typical conditions for an economic slowdown. Our companies confirm that their businesses remain strong.

Should we be scared? Recessions are a normal part of the economic cycle. We've all lived through several of them in our lifetimes. It may make for a bumpy 6-to-12 months, but in the long term, the U.S. economy and markets will recover. In fact, capital markets tend to rebound **while we're** in a **recession** as traders look beyond the horizon to a re-expanding economy.

Recessions create volatility in markets, and this means opportunity. Recently, we've been excited about several businesses in a way we haven't been in quite some time. We're sharpening our pencils and waiting with anticipation for prices that will allow us to make good long-term investments for you. It's a little silver lining on a cloudy day.

The Fed's interest rate policy has created a strong dollar, as foreign investors flock to buy higher yielding Treasuries. In fact, the dollar is stronger than it has been since the 80s versus most major currencies, including the euro, the pound and the yen. This is not great for British, European, or Japanese consumers, as they will pay more for imported U.S. goods and for dollar-denominated oil and gas. Eventually, it will help their exports to the U.S., and so stimulate economic recovery.

On the other hand, as U.S. citizens, this will have the opposite effect, and as U.S. investors, it will cloud the skies somewhat in terms of how our global companies report their results. If one of your companies earned 100 million euros in 2021 and then 115 million euros in 2022, on the surface, we would say, "Good job!" 15% growth is favorable and reflects a better than average performance versus the growth in the European GDP or inflation. However, consider that since last year the euro has depreciated against the dollar by about 15%. When these numbers get translated back into dollars, it will actually be reported in the company's financial statements as if the company's business in Europe shrank a bit. Portraying the European business as having shrunk is actually misleading – in fact, the company grew and generated more profit; however, reporting conventions follow certain rules that can sometimes be distortive. Long-term, the business is growing and healthy, but we will need to weather this reporting turbulence.

However, there is one domain where the strong dollar is an unmitigated benefit. If you haven't gotten your post-COVID revenge travel out of your system, now is a great time to plan a trip to almost anywhere in the world. When we were in Europe ten years ago, the dollar was worth three-quarters of a euro, and today the dollar is worth a whole euro. For U.S. travelers, everything you buy in Europe today is on sale for one-third off. That's like "Stay for 12 days but only pay for 9!" or "Buy 9 bottles of Burgundy and receive 3 for free!"

If you're planning to wait until the spring to travel to Europe, no one knows if the dollar will still be as strong, or perhaps the euro will appreciate, or the dollar could be even stronger. To hedge your bet, and lock in at least some of this discount, you may want to consider going down to the bank and buying some euros (or pounds or yen) now to lock in these favorable exchange rates. If you prefer a credit card, you can buy foreign currency online using a Visa debit card from a Fintech that allows you to store value on the card in your chosen currency.

But wait! Didn't we tell you just last quarter that we don't speculate in currencies? Indeed! But you're planning to travel, you're not speculating, you're hedging. If you know you will have expenses in euros in the spring, why not lock in the favorable exchange rate now? It's not much different than buying a plane ticket from Boston to Paris now because you think today's Air France fare is reasonable versus what it will be the week before you plan to depart. We don't usually think about currencies and goods like plane tickets in the same way, but in this case they're similar.

Recessions are an inevitable part of the economic cycle. They are normal, and in the long run, nothing to fear. Although the outlook is cloudy and we will hit some bumps, we should take advantage of the opportunities that a recession presents. We will be here buying quality assets at more reasonable valuations for you, and while we're doing that, if you happen to have a trip planned to see the world, now is a historically favorable time to lock in some good deals.

On another topic, you'll note that this quarter's company commentaries reflect a number of in-person visits with our companies. It is great to once again be able to get out of the office and spend time with managements on their own turf.

Please don't hesitate to contact us if you have any questions.

Sincerely,

Paul, Eric, LJ, Dan and Howie

* * * *

The views expressed in this sample quarterly letter are those of Marble Harbor Investment Counsel ("MHIC"), are subject to change at any time, and MHIC disclaims any responsibility to update such views. None of the information contained herein is intended as investment advice or securities recommendations. Past performance is not a guarantee of future results.